PAPER – 2 : AUDITING AND ASSURANCE

QUESTIONS

1. State with reasons (in short) whether the following statements are True or False.

   a. Statutory audit means an audit where duties, rights etc. of the auditor are laid down by law.

   b. Auditor should not disclose to his client anything that comes to his notice during audit.

   c. There is no difference between “fraudulent financial reporting” and “window dressing”.

   d. If company’s cash is used personally by the cashier and is made up on demand by the managements, it can be said that the financial statements are misstated.

   e. Loss of major markets means that going concern assumption is lost.

   f. As soon as audit report is signed and issued, auditor should destroy audit working papers.

   g. There is a inverse relationship between detection risk and combined level of inherent and control risk.

   h. SA 402 deals with responsibility of the auditor of the service organisation.

   i. Vouching is mere comparison of the entries in the books of account with evidence supporting the entries.

   j. Change of method of depreciation is entirely at the discretion of the management of the company.

2. Tabulate six documents or papers, which would normally be retained on the permanent audit file for a limited company.

3. Write short note on - Audit Note-book

4. Distinguish between test checking and routine checking.

5. What is meant by the expression ‘examination in depth’ and illustrate by reference to the verification of a payment made to a creditor for goods supplied.

6. Distinguish between Internal control and Internal check.

7. As an auditor, how would you safeguard your client against payment for the fictitious purchases verifying the purchases?

8. As an auditor what evidence would you look for to verify the following amounts appearing in the balance sheet ?

   (a) Leasehold building

   (b) Rates paid in advance

(c) Salesman's commission

(d) Interest receivable

9. An auditor of a limited company did not verify the investment; he inserted a note in the balance sheet – "Investment not verified". The shareholders approved and adopted the accounts at the annual general meeting. Subsequently, it transpired that the investments were misappropriated and the company suffered a loss.

   Can the auditor be sued for damages for negligence or otherwise in the discharge of his duties?

10. Under what circumstances a retiring auditor of a company cannot be reappointed.

11. Distinguish clearly between contingent liability and future liability.

12. What are the differences between government audit and commercial audit.

13. Write short notes on the following :

    a. Compliance procedure

    b. Substantive procedure

    c. Compliance procedure vs. Substantive procedure

14. What are the methods of selecting the sample items under SA 530.

15. A trader is worried that in spite of substantial increase in sales compared to the earlier year, there is considerable fall in gross profit, after satisfying himself that sales and expenses are correctly recorded and that the valuation of inventories is on consistent basis, he wants you to ensure that the purchases have been truthfully recorded. In the circumstances, how would you proceed with the assignment.

16. Comment – The sale proceeds from scrap, which did not have a significant value, need to be verified if the company had a good accounting and costing system.

17. What are the provisions related to fixed assets under CARO, 2003?

18. Lini Limited had issued debentures, which had been guaranteed by the Government of India both as to the repayment of principal and interest. The company disclosed the same as "Secured loans" in their balance sheet.

19. Akash Ltd. has its registered office at New Delhi. During the current accounting year, it has shifted its corporate Head Office to Haryana though it has retained the Registered Office at New Delhi. The Managing Director of the company wants to shift its books of account to Haryana from New Delhi, as he feels there is no legal bar in doing so.

20. Mention important points to be considered while auditing Cinema Hall.

21. How will you verify the following fixed assets ?

    (a) Plant and machinery

    (b) Furniture and fixtures

    (c) Motor vehicles

22. “Installation of computer operating systems has created both benefits and problems for auditors”. Discuss the statement.

23. Write short notes on the following:

    (a) Audit enquiry under Section 227(1A)

    (b) Disclosure requirements of bank balances of a limited company

24. How the work of an expert should be evaluated before accepting the same as an Audit evidence?

25. Write a short note on - Capital Redemption Reserve.

SUGGESTED ANSWERS/HINTS

1. a. True: It means audit required by law. In such cases, law lays down the rights duties of auditors.

   b. False: Confidentiality in SA 200 means not to disclose information acquired in course of work to a third party without client’s consent unless there is a legal/professional duty to disclose.

   c. False: “Fraudulent financial reporting” is wider term than “window dressing”. Fraudulent financial reporting covers both accounts made to show better position than actual (window dressing) and accounts being made to show worse position than actual.

   d. True: The amount detected and recorded may only be “tip of the ice-berg”. It may suggest serious weaknesses in internal controls. Knowledge of what the employee did ought to have a direct bearing on the nature and details of checks to be applied in relation to matters dealt with by the employee.

   e. False: The loss of major markets is only an indication that going concern assumption may not be appropriate. It is not a conclusive evidence that going concern assumption is not be appropriate. There may be mitigating factors such as a compensating new major market.

   f. False: According to Expert Advisory Committee’s view, auditor should normally maintain working papers for 10 years.

   g. True: There is inverse relationship between detection risk and combined level of inherent and control risk. When inherent and control risk are high, the auditor accepts a low level of detection to reduce overall audit risk. (SA 315 “Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment” and SA 330 “The Auditor’s Responses to Assessed Risks”

   h. False: SA 402 “Audit Considerations Relating to Entities Using Service Organizations” deals with responsibility of auditor whose client uses a service organization. In other words, it deals with responsibility of auditor of the client of the service organization.

i. False: Vouching is not mere comparison of the entries with the supporting documents. It is a critical examination of the supporting documents to understand the substance or essence of the transaction and to ensure that the transactions is accounted for as per its substance.

j. False: Method of depreciation can be charged only if such change is required by statute/ Accounting Standards or such change would result in more appropriate presentation of entity's financial statements.

2. The documents or papers, which would normally be retained on the permanent audit file for a limited company, include the following:

   (a) Copies of the Memorandum and Articles of Association.

   (b) Details of the corporate structure and management organisational plan.

   (c) Extracts from the minutes, contracts and any other documents, which have continuing importance to the audit.

   (d) Relevant financial information including ratios and trends covering the previous ten years.

   (e) Knowledge of the business giving the history of the company and details about its products and the markets in which it operates.

   A copy of any bank certificate request letter sent by the client to its bankers asking that the auditors should be supplied with information regarding bank balances, securities held in safe custody.

3. Audit Note Book

   An audit note book is usually a bound book in which a large variety of matters observed during the course of audit are recorded. Audit note books form part of audit working papers and for each year a fresh audit note book is maintained. In case an auditor classifies his working paper into permanent and current, then audit note book shall form part of the current file. It is in any case a part of the permanent record of the auditor available for reference later on, if required.

   The audit note book also provides a valuable help to the auditor in picking up the links of work when the concerned assistant is away or the work is stopped temporarily. It is also used for recording the various queries raised in the course of the work and their state of disposal. In respect of disposed queries, explanation obtained and evidence seen would be recorded in the said book, while queries remaining undisposed of would be noted for follow up.

4. Test checking and routine checking can be distinguished on the basis of following points:

   (a) Concept: Test checking involves selecting a few transactions on the basis of auditor's judgment and examining them. But routine checking involves checking of books and records.

(b) Object: The main object of test checking is to form an opinion on the financial statements on the basis of examination of selected sample. While the main object of routine checking is ensuring arithmetical accuracy of the entries in the original books and ledgers and posting to correct ledgers accounts.

(c) Relationship: Routine checks may be performed on the basis of test checking.

5. 'Examination in depth' involves the tracing of a transaction through the different stages from its initiation to its conclusion. The records and supporting vouchers applicable at each successive stage are examined to an appropriate extent, bearing in mind the quality of internal check operating at that stage.

   For example, the verification of a payment made to a trade creditor for goods supplied is frequently carried out by simply examining the paid cheque returned from the bank ensuring that it is drawn in favour of the creditor and restrictively crossed. Verification of this transaction 'in depth', however, would involve examination of the following further items:

   (a) A copy of the original order and the authority thereof.

   (b) The goods received not and evidence that the goods have been examined to ensure their conformity with the original order, both as to quantity and quality.

   (c) The supplier's invoice and statement of account.

   (d) Evidence in the stock records of the inclusion of the goods into stock.

6. Internal control and internal check

   (i) Scope: Internal control comprises the whole system of controls, financial or other wise established by the management for the conduct of business. It includes internal check and internal audit besides other controls. But internal check refers to a system of allocating duties among the staff in such a manner that every person records a different aspect of a transaction. It is narrower in scope.

   (ii) Objects: A system of internal control strives to achieve objectives such as adherence to policies and procedures laid down by management, safeguarding of assets, prevention and detection of errors and frauds, accuracy and completeness of records and timely preparation of reliable financial information. On the other hand, internal check system is designed to prevent errors and frauds and fixing responsibility and safeguarding assets. It is a part of internal control system.

   (iii) Flexibility: Internal control system is reviewed occasionally by the management in the light of changes within the organisation, in the economic environment and suggestions of internal auditor and external auditor. But internal check once introduced in the business is generally stable for a certain period and, hence, less flexible as compared to internal control system.

   (iv) Example: Internal control with regard to credit sales in an organisation would consist of internal check system, physical controls, authorisation procedures and review. Internal check system will comprise of allocation of functions among various departments – sales department (for accepting customer order); credit department (for credit approval); warehouse (for issue of merchandise); despatch department (for despatching goods) and finance or billing department (for billing customers).

7. The auditor has to be very cautious while verifying the purchases that no payments have been made for the fictitious purchases. For this purpose, he may have to take the following actions:

   - He should examine first the internal control system in connection with purchases and satisfy himself with regard to its effectiveness.
   - He should ensure that before passing the invoices for payment, they are checked with the original order, with goods received book and the stock records.
   - He should inspect the invoices and see that the authorities responsible for passing them for payment have duly checked them and initialled.
   - He should test check the invoices to see that dates given in the invoices are for the period concerned and they have been addressed in the name of the client.
   - He should also compare a number of invoices with the records in the goods received book and stock records.
   - He can make physical verification of the goods purchased, if a part of it is still in the stock.
   - He should also compare the supplier's statement with the supplier's account.
   - Postings in the various suppliers' accounts should also be checked and compared with the statement received from them.

8. Evidence required for the verification of the following:

   (a) Leasehold building

   (i) on existing – physical inspection of the property

   (ii) on ownership – inspection of the lease agreement noting down the duration and terms including premium paid.

   (iii) on valuation – checking of the calculation of the premium paid being written off over the duration of the lease.

   (iv) on disclosure – depending on the length of lease left to run, the amount should be disclosed as long or short period leasehold building in the fixed category.

   (b) Rates paid in advance

   (i) The original rates demand notice should be obtained and the period and the amount to be noted.

   (ii) The actual payment should be checked from the cash book.

   (iii) The calculation of the prepayments should be checked.

   (iv) The item should be included in current assets in the balance sheet.

(c) Salesmen's Commission

   (i) Evidence of the existence of the salesmen from personnel records

   (ii) Evidence of the rates by reference to contracts of employment. Calculations should be checked.

   (iii) Evidence of sales by reference to a sample of sales invoices.

   (iv) Any amounts due but not paid should be included in creditors and can be checked against invoices and the payroll.

(d) Interest receivable

   (i) The amount of the loan or deposit on which the interest is earned should be established at various periods.

   (ii) The loan or deposit certificate or agreement gives the interest rate and the calculation can be checked.

   (iii) The date of the last payment can be verified from the cash book and the receipt of the interest after date may also be checked from cash book and the bank statement.

   (iv) If the amount is due from a bank, confirmation should be possible via the bank letter.

9. In case of audit of a limited company, an auditor has to comply with the statutory duties as prescribed in the Companies Act, 1956. Verification of investments is a very important function of an auditor, since, it is an important asset shown in the balance sheet. The auditor cannot be expected to give a report on the 'truth and fairness' of the financial statements of the company without verifying its investment. If he specifically mentions in his audit report the fact that, he did not verify the investments, he would not be relieved from his statutory duties. Such statutory duties can never be curbed, though they may be extended.

   Under Section 543 of the Companies Act, 1956 the auditor may also be held guilty for misfeasance or breach of duty in relation to the company in the event of winding up, provided such misfeasance has directly resulted in damages to the company.

   Thus, the auditor will be held liable in this case as the company suffered a loss because of such breach of duty.

10. Ordinarily, an auditor appointed by whatsoever authority, is to be compulsorily re-appointed by passing a resolution at the annual general meeting. However, the retiring auditor shall not be re-appointed in the following cases :

   (i) if he is not qualified for re-appointment; or

   (ii) if he has given the company notice in writing about his unwillingness to be re-appointed; or

   (iii) If a resolution has been passed at the meeting –

(a) appointing somebody other than him; or

(b) providing expressly that he shall not be re-appointed; or

(iv) if a notice has been given of any resolution proposing the appointment of some other person in place of the retiring auditor (even if such a resolution could not be proceeded with due to death, incapacity or disqualification of that person proposed as auditor).

11. A contingent liability is one, which may or may not become an actual liability at a future date depending upon the happening of certain event. Thus, a contingent liability is a future liability, where a future liability need not be a contingent one. For instance, a liability in respect of damages, for which the case is pending before the court of law is a contingent liability and if according to the courts' decision, the liability is settled, it will become a future liability. It would become a future liability only when the court gives the judgment against the company. Otherwise it will not be a liability for the company at all. Such uncertainty regarding liability does not exist in case of a future liability.

    A future liability is a real liability. It is an accruing liability, which has to be paid by a company at a future date, and there is no uncertainty in this respect. For example, if a company is under legal obligation to pay gratuity, it is a future liability and has to be paid at a future date.

12. Government audit is not same as commercial audit. Certain special aspects are required to be covered under government audit, which are not at all required for commercial audit.

    The distinction between government audit and commercial audit can be outlined in the following way:

Points of distinction	Government Audit	Commercial Audit
1. Nature of Audit	Government audit is conducted almost continuously throughout the year, because the number of transactions is many and involves large sums of money.	Commercial audit is mostly periodical in nature
2. Auditor	The audit officers of the Indian audit and accounts department do government audit.	Professional chartered accountants mostly conduct commercial audit.
3. Dominating factor	Propriety-cum-efficiency audit is predominant in government audit.	This aspect is not strictly adhered in case of commercial audit.
4. Preparation of accounts	In this case, the Indian audit and accounts department	In commercial audit, the auditor audits the accounts

	including its field offices prepares or compiles the major part of government accounts and also audits the accounts.	prepared by others. The auditor is not at all responsible for the preparation and/ or compilation of accounts.
5. Method of accounting	In government audit, the auditor has to see whether the accounts have been prepared according to the prescribed rule of government accounts.	In commercial audit, the auditor has to see whether the accounts have been prepared on the basis of double entry system.
6. Objective	Government audit is concerned with examining the propriety of expenditure.	The primary objective of this audit is to see whether the balance sheet prepared gives a true and fair views of the state of affairs of the enterprise and the profit and loss account gives a true and fair view of the profit or loss of the enterprise.
7. Vouching of payment	Government spending is done by the treasury officer or disbursement officer, who makes a detailed scrutiny of the bills before payment. So, government auditor is relieved of detailed checking of payments.	In commercial offices, the cashier does not have to make such a scrutiny before payment. So, payments require proper vouching in commercial audit.

13. a. Compliance procedures: The compliance procedures are audit tests designed to obtain a reasonable assurance as to reliability of internal control system. They seek to test:

    (i) that the internal control exists, i.e., existence,

    (ii) that the internal control is operating effectively, i.e., effectiveness and

    (iii) that the internal control has so operated throughout the period under audit i.e. continuity.

    b. Substantive procedures: The substantive procedures are audit tests designed to obtain evidence to verify balance of an account or a specific financial statement assertion. In other words, they test the validity and propriety of the accounting treatment of transactions. They can be classified as either test of details of transactions and balances or as analytical review procedures. They seek to test:

(i) existence that an asset or a liability exists at a given date,

(ii) rights and obligations that an asset is a right of the entity or is owned by the entity and a liability is an obligation of the entity at a given date,

(iii) occurrence that a transaction or event occurred and pertains to the entity during the relevant period,

(iv) completeness that there are no unrecorded assets, liabilities or transactions,

(v) valuation that asset or liability is recorded at an appropriate carrying value,

(vi) measurement that a transaction is recorded at the proper amount and revenue or expense is allocated to the proper period and

(vii) presentation and disclosure an item is disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory requirements, if any.

c. Compliance procedures vs. Substantive procedures

Basis	Compliance Procedures	Substantive Procedures
(i) Nature	Are used to access the reliability of internal control system.	Are designed to assess the validity and propriety of accounting treatment of transactions.
(ii) Nature of evidence	Provide evidence as to whether misstatement is likely	Provide evidence as to whether misstatement exists
(iii) Dependence	Nature, timing and extent of compliance procedures do not depend upon result of substantive procedures.	Nature, timing and extent of substantive procedures depend upon results of compliance procedure.

14. Three method of sample selection have been mentioned under SA 530. These are

(1) Random selection

Random sampling is a method of sampling in which sample is selected at random i.e., in a manner that ensures each element in the population has an equal chance of being selected, for example, by use of random number tables.

(2) Systematic random sampling

Under this method every item out of a series is selected to make a sample and ‘n’ being the sampling interval. The first number is picked randomly.

(3) Haphazard selection

- This method is an acceptable alternative to random selection, provided the auditor attempts to draw a representative sample from the entire population with no intention to either include or exclude specific units.
- When the auditor uses this method, he has to take guard against making a selection that is biased, for example, towards items which are easily located as

they may not be representative.

15. There should be three steps involved in such an assignment.

- Study and evaluation of internal control system
- Vouching of purchase transactions
- Analytical procedures

The specific internal control procedures for purchase of goods for inventory are summarised below:

(i) Internal check: It should consist of the segregation of duties at the following points:

(a) Requisitioning the goods: Specified employees from stores department or from production department's store unit should prepare and approve a purchase requisition for raw materials or goods used in production. The purchase requisition is sent to the purchasing department.

(b) Ordering the goods requisitioned: The purchase department is responsible for negotiating the best prices, fixing delivery dates with suppliers and ensuring that appropriate quality goods are obtained. It should prepare a serially numbered purchase order.

(c) Receiving the goods ordered: Goods ordered should be inspected and counted by the receiving department. If satisfied, it prepares serially numbered receiving report or goods received note and forwards its notification copies to the stores, purchase department and finance department.

(d) Preparing the payment voucher: The accounts payable department or accounts payable unit of finance department will receive the invoices. Daily voucher summary is prepared by the accounts payable unit / department.

(ii) Physical controls

(a) Physical controls over inventory include locked warehouses and store-rooms and limiting access to them to authorised personnel.

(b) Printed and prenumbered forms should be used for purchase requisitions, purchase orders, receiving reports and vouchers.

(iii) Authorised procedures

(a) Re-order points should be established for various inventory items that may trigger a manual request.

(b) Authorisation procedures should be designed for all the four control points – requesting the goods, ordering the goods requisitioned, receiving the goods ordered and preparing the payment voucher.

(iv) Internal review

(a) It should ensure that there is adequate separation of duties and proper authorisation procedures with regard to processing and recording of purchase transactions.

(b) Paid invoices should be reviewed to ascertain the accuracy of the recording of these invoices and if possible, these invoices should be traced back to purchase requisition through receiving reports or goods received notes and purchase orders.

- Vouching of purchases

The auditor should vouch credit purchases by following the audit procedures mentioned below:

(i) Examine purchase book: The auditor should examine the transactions recorded in the purchase book with reference to related purchase invoice.

(ii) Examine purchase invoices: The auditor should select a small sample of vendors' invoices at random and should conduct in-depth audit on them i.e., trace the transaction from placing the order to the entries in inventory goods for actual receipt and payment made to the suppliers. In respect of imports, documents such as bill of lading, customs clearance, etc. should be examined. The auditor should ensure that subsidies, rebates, duty drawbacks or other similar items have been properly accounted for.

(iii) Examine the numerical sequence of source documents: The auditor should ensure the numerical sequence of source documents such as purchase requisitions, purchase orders, receiving reports and vouchers have been maintained and missing numbers have been duly accounted for.

(iv) Examine cut off points: In order to ensure that purchases were recorded at that point of time when title was passed to the client, the auditor should examine cut-off points on prenumbered purchase requisitions, purchase orders and goods received notes. The auditor should, then, trace the goods received notes pertaining to a few days before the end of the period under audit to the related purchase invoices. Such a comparison would ensure that purchases represented by such invoices have been recorded as the purchases of the period under audit.

(v) Examine transition with related parties carefully.

- Analytical procedures

Compare item-wise and location-wise both quantity and value of purchases for the current period with the corresponding figures for previous period.

16. (i) SA 320, "Audit Materiality" has established the concept of materiality and the standards for consideration of the auditor with regard to it. According to it, materiality can be judged from the impact of the item at the overall financial statement level or at the individual account balance. Thus, even a small amount can be material.

(ii) The auditor reviews the cost records and financial records generated by accounting system to determine the total value of scrap that has been generated during the period under audit.

(iii) If the entity has a sound accounting and costing system, the auditor can rely on the data given by such systems for verifying the value of scrap, but cannot give up its verification. As already stated, even a small amount can be material, as per SA 320, if it affects significantly any account balance. The revenue from scrap is either recorded as sales revenue or is reduced from the cost of the product. If auditor does not verify sale proceeds from scrap, either of the above would be materially misstated.

17. The auditor's report under CARO, 2003 should include statements on the following three matters relating to fixed assets:

(a) Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets.

(b) Whether these fixed assets have been physically verified by the management at reasonable intervals, whether any material discrepancies were noticed on such verification, and if so, whether the same have been properly dealt within the books of account.

(c) If a substantial part of fixed assets has been disposed of during the year, whether it has affected the going concern. The phrases in bold and italics are discussed below.

(a) Proper records

- These would vary from one circumstances to other.
- Generally, proper records should cover following aspects related to assets –
  - Sufficient description,
  - Classification,
  - Location,
  - Quantity,
  - Original cost with year of purchase, details regarding revaluation, if any,
  - Rate of depreciation and accumulated depreciation,
  - Impairment details
  - Sale or disposal of asset, etc.
- The aggregate original cost, depreciation to date and impairment loss as per these records should match with figures shown in the books of account.
- The location of fixed assets should be so shown that it makes their physical verification possible e.g., movement register should be maintained for assets on construction sites.

- The particulars relating to quantitative terms of assets may differ e.g. land can be identified by survey numbers and by deeds of conveyance. Plant and machinery can be divided as fixed and movable. Fixed items of plant and machinery may be further sub-divided as process wise or sub-process wise.
- If records do not show that cost of different units of fixed assets separately, allocation of the total cost should be made by analysing the purchases and disposal of the preceding years.

(b) Physical verification

- Examine whether there is adequate evidence that physical verification of fixed assets was carried out by the management. To establish adequacy of evidence he should examine the relevant working papers and written instructions issued by the management to its staff.
- Reasonable interval should be construed by considering factors like the number, nature, value and geographical spread of fixed assets.
- The auditor may decide whether a discrepancy is material or not in the light of nature location and the cost of the asset, total cost of all fixed asset and other relevant factors.

(c) Disposal of substantial part of fixed assets

- What constitutes substantial part of fixed assets depends primarily on the facts and circumstances of each case.

18. (i) According to the requirements of Part I of Schedule VI to the Companies Act, 1956 ' Secured loans' are shown on the liabilities side of the balance sheet along with the nature of security being specified. The security offered should be in the form of a charge on a tangible asset. Secured loans are to be shown under four heads, debentures being one of them.

(ii) In the present case, debentures though guaranteed by the Government of India both as to the repayment of principal and interest should not be disclosed under the head – 'secured loans'. As per the requirements of Part I of Schedule VI to the Act, cited above, for such a classification charge on tangible assets is required. Government guarantee is no tangible asset. Therefore, the debenture under the given case should be classified as 'Unsecured loans' in the balance sheet with a disclosure of the fact of Government guarantee.

19. (i) Under section 227 of the Companies Act, 1956, the auditor has to report whether the company under audit has maintained proper books of account as per requirements of section 209. Further, the books of account should be kept at the registered office of the company. However, the board of directors may decide to keep them or a part thereof, at any place in India other than registered office. If such a resolution is passed, the company must file with the Registrar of Companies the details of such address.

(ii) In the present case, the managing director of Akash Limited wants to shift the books of account from registered office at New Delhi to corporate head office at Haryana. This can be done, according to section 209, by passing a board's resolution and filing of such address with the Registrar of Companies.

20. (i) Preliminary work

(a) Ascertain the legal status of the cinema hall.

(b) Note the provisions of applicable statute.

(c) Examine important minute books.

(d) Study and evaluate internal control system.

(ii) Receipts

(a) Ticket sales

➢ Verify –

- that entrance to the cinema-hall during show is only through printed tickets;
- that they are serially numbered and bound into books;
- that the number of tickets issued for each show and class, are different though the numbers of the same class for the show on the same day, each week, run serially;
- that for advance booking a separate series of ticket is issued; and
- that the stock of tickets is kept in the custody of a responsible official;

➢ Confirm that at the end of show, a statement of tickets sold is prepared and cash collected is agreed with it and the unsold tickets on hand.

➢ Verify that a record is kept of the 'free passes' issued.

➢ Verify that free passes are issued under proper authority.

➢ Vouch the entries in the cash book in respect of cash collected on sale of tickets for different show with daily statements.

➢ Test check daily statements with records of tickets issued for the different shows held.

(b) Entertainment tax: Reconcile the amount entertainment tax collected with the total number of tickets issued for each class.

(c) Advertisement income: Verify the charges collected for advertisements slides and shorts by reference to the Register of Slides and Shorts Exhibited kept at the cinema as well with the agreements, entered into with advertisers in this regards.

(d) Restaurant income: The arrangement for collection of the share in the restaurant income should be entered into either as a fixed sum or a fixed percentage of the taking receivable annually. In case the restaurant is run by the Cinema, its accounts should be checked. The audit should cover sale of various items of foodstuffs, purchase of foodstuffs, cold drinks, cigarettes, etc. as in the case of club.

(e) Advance Bookings: Verify that advance bookings for shows to be held in next financial year have been carried forward and shown as liabilities in the balance sheet.

(iii) Payments

(a) Advertisement / Repairs / Maintenance expenses

- Vouch the expenditure incurred on advertisement, repairs and maintenance. No part of such expenditure should be capitalised.
- Expenditure on extensive redecoration, should not be adjusted as deferred revenue expenditure in view of AS 26.
- If they satisfy the criteria for capitalisation in para 23 of AS 10, they should be capitalise otherwise, they should be expensed as incurred.

(b) Depreciation: Confirm that depreciation on machinery and furniture has been charged at an appropriate rate which are higher, as compared to those admissible in the case of other businesses, in respect of similar assets.

(c) Film hire payments: Vouch payments on account of film hire with bills of distributors and in the process, the agreements concerned should be referred to.

(d) Advances paid on distributors: Examine unadjusted balance out of advance paid to the distributors against film hire contracts to see that they are good and recoverable. If any film in respect of which an advance was paid has already run, it should be enquired as to why the advance has not been adjusted. The management should be asked to make a provision in respect of advances that are considered irrecoverable.

(iv) Assets and liabilities

Verify them in usual manner.

21. (a) The audit procedures to verify the following assets are given below:

Plant and Machinery

Objective	Audit Procedure
(i) Existence and ownership	• Inspect Plant Register which contains detailed particulars relating to various machines and equipment alongwith their original cost, rate and amount of depreciation, accumulated depreciation, additionals and sales from time to time • Ensure physical verification of plant and machinery was done by the management; method adopted was

	reasonable; its frequency was reasonable and test check book records with physical verification reports. • Vouch new purchases with relevant documentary evidence. • Verify sale of plant and machinery with evidence indicating authorisation to sell, invoice copy, carbon copy or counterfoil of cash receipt and should ensure that journal entries have been passed to remove the entire related accumulated depreciation.
(ii) Possession and liens, if any	• Confirm the existence of lien or floating charge, if any, by inspecting register of charges, approval by appropriate authority, certificate from client's legal adviser and confirmation from mortgagee.
(iii) Valuation and disclosure	• Plant should be valued at cost of acquisition less depreciation. • Ascertain the basis for computation of cost in case of purchase of or construction of plant and machinery. • Ascertain whether profit or loss on sale of the machinery has been calculated correctly and disclosed properly in the profit and loss account.

(b) Furniture and Fixtures

Objective	Audit Procedure
(i) Existence and ownership	• Examine Stock Register which has details regarding the date of purchase, cost of furniture and fitting, depreciation rate, location stock number allotted to it and other facts. • Ensure stock number is painted on furniture and fitting. • Ensure that the management prepares a statement of inventory and reconcile it with stock register at the end of each period. • In case of purchase, verify the furniture with reference to authorisation by appropriate authority, purchase invoices, stock register and bank statement.
(ii) Possession and determine liens, if any	• These assets are rarely subject to lien. Physical inspection or relevant documents can be examined to determine it.
(iii) Valuation and disclosure	• These assets are valued at cost less depreciation. • Cost should be verified by reference to purchase

	invoices and vouchers of expense incidental to such purchase. • Ensure that cost of furniture and fittings which have become unserviceable has been written off to profit and loss account under proper authority. • Examine whether disclosure is as per statutory requirements, if any.

(c) Motor Vehicles

Objective	Audit Procedure
(i) Existence and ownership	• Examine registration certificate which contains information as to ownership, identification of the vehicle and other important details. • Examine insurance policies taken for motor vehicles and road tax receipts for information regarding ownership of the equipment. • Examine vehicle register, which is maintained if number of vehicles is large.
(ii) Possession and determine liens, if any	• Ensure if a floating charge is created it has been disclosed in the balance sheet.
(iii) Valuation and disclosure	• Assets should be valued and disclosed at cost less depreciation. • Cost includes purchase price and cost of accessories. • Ensure depreciation is being provided with reference to distance in kilometers covered by the vehicle as against the mileage which it is expected to run during its lifetime.

22. The benefits of installation of computer operating system to the auditor are as follows:

(i) Scientific random sampling: Computers help the auditor to select the sample for test checking in a scientific manner. This helps involving more effective testing.

(ii) Computer assisted audit techniques

- ➢ use of computer assisted audit techniques (CAAT) helps the auditor to examine data faster and more accurately than clerical audit tests;
- ➢ are cost effective; and
- ➢ can be used continuously until the file layouts are changed.

The disadvantages/ problems are:

(i) High speed: Data processing is carried out at high speed and this requires careful arrangement of data in batches and coding of data. Tracing of individual vouchers becomes difficult.

(ii) Concentration of duties: In a computer-based accounting system, internal controls are established by separation of knowledge not duties. Less number of people are required to perform accounting functions. It leads to concentration of duties.

(iii) Impact of poor system: The consequences of errors in a computer system are very serious. For example, an erroneous programme will treat wages and salaries as revenue item but there might be a need to capitalise these in case of installation of machinery. Errors in EDP system, which the auditor detects, may involve extensive redesign and reprogramming.

(iv) Lack of audit trail: In a computer based accounting records system audit trail is often missing. Transactions are recorded electronically and thus, source documents are not generated. The auditor should be aware of this problem and designs his procedures accordingly.

(v) Tight scheduling: Audit of computerised accounts or EDP auditing, generally, involves tight scheduling. This is because the client has to make arrangements to provide auditor access to computer system and make available various files. The auditor should carefully assess the staffing requirements beforehand. The client, too, has to follow the schedule given by the auditor tightly.

(vi) Weakening of internal controls: The concentration of accounting functions in few hands, possibly no back up data and formulation and implementation of different types of control by non-accountants weaken the internal controls. The organisation should design adequate general and application controls to overcome the above mentioned problems.

23. (a) Audit enquiry under Section 227(1A): Auditor is required to make an enquiry and report under Section 227(1A) of the Companies Act, 1956, if he is not satisfied in respect of the following matters:

(i) Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the company.

(ii) Whether the transactions which are represented by mere book entries are not prejudicial to the interests of the company.

(iii) Where the company is not an investment company within the meaning of Section 372, or a banking company, whether so much of the assets as consist of shares and debentures and other securities have been sold at a price less than that at which they were purchased by the company.

(iv) Whether loans and advances have been shown by way of deposits.

(v) Whether the personal expenses have been charged to revenue.

(vi) Where it is stated in the books and papers of the company that any shares have been allotted for cash whether the cash has actually been received and if no cash has been received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

(b) Disclosure Requirements for Bank Balance

As per Part I of Schedule VI to the Companies Act, 1956, the disclosure requirements for bank balance are as under:

(i) Bank balance with scheduled bank.

(ii) Bank balance with banks other than scheduled banks.

The other particulars are to be stated are as under:

(i) Balances lying with scheduled banks in current accounts, call accounts, deposit accounts.

(ii) Where the balance is with non-scheduled bank, the name of the banker, balances lying with such bankers on current accounts, call accounts and deposit accounts, the maximum amount outstanding with them during the year should be specified.

24. Using the work of an expert: As per the SA 620, when the auditor intends to use the work of an expert he should evaluate the following before accepting the same as audit evidence:

(i) Professional qualification of the expert;

(ii) Experience and reputation of expert in related field;

(iii) Independence and objectivity of the expert;

(iv) The objectives and scope of the expert's work;

(v) Expert's relationship with the client, if any;

(vi) The source data used;

(vii) Assumptions and method used;

(viii) the results of the expert's work in the light of auditor's overall knowledge of the business and of the result of his audit procedures.

25. Capital Redemption Reserve: As per Section 80 of the Companies Act, 1956 where preference shares are redeemed otherwise than out of a fresh issue, these shall be out of profits, otherwise available for dividends, be transferred to a reserve fund called Capital Redemption Reserve Account, an amount equal to the nominal value of the shares redeemed. The provisions of the Companies Act, 1956, relating to the reduction of share capital of a company shall apply as if the Capital Redemption Reserve account were paid up share capital of the company. The Capital Redemption Reserve Account may be applied by the company in paying up in issued share of the company to be issued to members of the company as fully paid up bonus shares. Capital Redemption Reserve should be disclosed under the head "Reserves & Surplus" on the Liabilities side of the Balance Sheet as per Pasrt-I of Schedule VI to the Companies Act, 1956.

List of Institute publications - November, 2009

I. Statements and Standards

1. Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services.

2. Standards on Auditing as given below

S.No. Standards on Auditing and Number (All these SAs have been hosted in the Institute's Website).

1. Basic Principles Governing an Audit (SA 200)
2. Objectives and Scope of the Audit of Financial Statements (SA 200A)
3. Terms of Audit Engagement (SA 210)
4. Quality Control for Audit Work (SA 220)
5. Audit Documentation (230) (Revised)
6. The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements (SA 240) (Revised)
7. Consideration of Laws and Regulations in an Audit of Financial Statements (SA 250) (Revised)
8. Communication of Audit Matters with Those Charged with Governance (SA 260) (Revised)
9. Responsibility of Joint Auditors (SA 299)
10. Planning an Audit of Financial Statements (300)
11. Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment (SA 315) (Newly issued)*
12. Audit Materiality (SA 320)
13. The Auditor's Responses to Assessed Risks (SA 330) (Newly issued)*
14. Audit Considerations Relating to Entities Using Service Organisations (SA 402)
15. Audit Evidence (SA 500)
16. Audit Evidence - Additional Considerations for Specific Items (SA 501)
17. External Confirmations (SA 505)
18. Initial Engagements – Opening Balances (SA 510) (Revised)
19. Analytical Procedures (SA 520)
20. Audit Sampling (SA 530) (Revised)
21. Auditing of Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures (SA 540) (Revised)
22. Related Parties (SA 550) (Revised)
23. Subsequent Events (SA 560) (Revised)

24. Going Concern (SA 570) (Revised)
25. Written Representations (SA 580) (Revised)
26. Using the Work of Another Auditor (SA 600)
27. Relying Upon the Work of an Internal Auditor (SA 610)
28. Using the Work of an Expert (SA 620)
29. The Auditor's Report on Financial Statements (SA 700)
30. Comparatives (SA 710)

Note 1:

* Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (erstwhile AAS 1) and SA 200A (erstwhile AAS 2) will be merged into one Standard, i.e. SA 200.)

** SA 315 & SA 330 – become effective in April, 2008. For November 2009 Final (Old) Examination 34 standards on Auditing as given in the Annexure – I. The Standard on Auditing (SA) 400, "Risk Assessments and Internal Control", SA 310, "Knowledge of the Business", and SA 401, "Auditing in a Computer Information Systems Environment", issued in June 2002, April 2000 and January 2003, respectively, would stand withdrawn.

Note 2:

Newly issued SA 450 "Evaluation of Misstatements Identified during the Audit"Effective for all audits relating to accounting periods beginning on or after April 1, 2010. It is not applicable for the November, 2009 examination.

3. Statement on Reporting under Section 227(1A) of the Companies Act, 1956
4. Statement on the Companies (Auditor's Report) Order, 2003 [2005 Edition].

II. Guidance Notes/Study Guide/Monograph

Guidance Notes on Auditing Aspects:

1. Guidance Note on Audit of Fixed Assets.
2. Guidance Note on Audit of Inventories.
3. Guidance Note on Audit of Debtors, Loans and Advances.
4. Guidance Note on Audit of Investments.
5. Guidance Note on Audit of Miscellaneous Expenditure.
6. Guidance Note on Audit of Cash and Bank Balances.
7. Guidance Note on Audit of Liabilities.
8. Guidance Note on Audit of Revenue.
9. Guidance Note on Audit of Expenses.